# APPENDIX 1

## The Scottish Parliament
## Local Government and Regeneration Committee
## Greater Manchester Pension Fund – Local Investment

### 1. EXECUTIVE SUMMARY

1.1 This submission to the Local Government and Regeneration Committee sets out how Greater Manchester Pension Fund (GMPF) has invested in its local economy. The Fund's local investment programme has delivered its twin aims of commercial returns net of management and governance costs and has generated a positive local impact through significant property development and job creation.

- Commercial returns are defined as the return required by the actuary to help deliver low stable employer contribution rates to employers whilst maintaining the solvency of the Fund;

- To generate positive local impact, the Fund invests in the North West with a focus on Greater Manchester. This can include direct investment by the Fund and working with public and private sector partners investing in property and local businesses.

1.2 There are significant fiduciary and reputational risks in making local investments and it is crucial that the appropriate governance structure and other controls are in place to mitigate these.

1.3 This paper covers the background to GMPF and its governance structure, sets out the legal position, gives descriptions of its local investment programmes and assesses the benefits and risks of local investment.

### 2. GMPF BACKGROUND AND GOVERNANCE STRUCTURE

2.1 GMPF is the largest Local Government Pension Scheme Fund (LGPS) in England and Wales. The Fund grew significantly last year with it becoming the "one LGPS fund" for probation staff as part of the Government's Transforming Rehabilitation programme. This resulted in £3bn of additional assets and 42,000 new members joining the Fund. This was the equivalent of adding another Manchester City Council size Employer to the fund.

2.2 The key statistics for the Fund are:

| | |
|---|---|
| Membership | |
| • Employees | 113,000 |
| • Deferred | 117,000 |
| • Pensioners | 111,000 |
| Total | 341,000 |
| Assets | £17bn |
| Employers | 400+ |
| 20 year investment return to 31/3/14 | 8.5%p.a. (ranked 2nd against LGPS funds in England and Wales) |
| Funding level at 2013 valuation | 90.5% in 2013 (ranked 3rd using like for like assumptions out of 89 Funds) |

2.3 GMPF has a very successful long term track record achieved through good decision making and strong governance. Contributing factors to the Fund's long term success include:

(1) *Stability*

- of the leadership of the Fund – many members of the Fund's Management Panel have long service and this experience together with training has helped build skills and knowledge;
- of advice from the Fund's external advisors and in-house staff;
- in the investment management arrangements, appointed managers and other service providers

(2) *Economies of Scale*

- in terms of lower unit costs; and
- the capacity to buy in external and in-house expertise

(3) *Inclusive and Consistent Governance Arrangements*

- All 10 Greater Manchester local authorities and 6 trade union representatives are involved in decision making. This helps decisions to be taken from a long term perspective and helps build constancy of purpose which is complimented by a Core Belief Statement that sets out the Panel's investment beliefs. It is also important that the arrangements support "fleet of foot" decisions.

These factors have also been beneficial in developing the local investment programme.

2.4 The Fund has a long history of investing locally within Greater Manchester and the wider North West. This investment has the twin aims of generating commercial returns and supporting the local area/economic regeneration. The generation of commercial returns is critical to:

- contribute to the Fund's key aim of delivering low stable employer contribution rates whilst maintaining the solvency of the Fund; and
- satisfying the fiduciary duty requirement.

2.5 Investing in the local economy also has other beneficial effects for the Fund and its stakeholders who are seen as employer organisations, employees and local tax payers. These include.

- Improvements to the local economy securing the revenue base for employer organisations which also helps them to meet contributions to the Fund.
- Creation of jobs.
- Improvement of business environment

2.6 Local investment is resource demanding and carries reputational risks. The GMPF Management Panel has working groups to lead, oversee and support its operations, all of which meet quarterly. The Fund's Policy and Development Working Group (which is chaired by the Chair of the Management Panel) oversees local investment and its terms of reference include.

- to consider in detail opportunities for local investments that may satisfy the twin aims of commercial returns and supporting the area, and make recommendations on these categories of investment and where appropriate the range of allocations to the Management Panel.

- to consider the resource implications of investment programmes, determine priorities and make recommendations to the Panel
- To monitor and evaluate the progress of new investment programmes, (established programmes are monitored by the other working groups)
- To provide guidance to the Director of Pensions in exercising delegated powers.
- To consider proposals for joint working with other funds / institutions.

## 3. INVESTMENT RESTRICTIONS AND FIDUCIARY DUTY

3.1 The LGPS Regulations require funds to:

- consider the advisability of investing fund money in a wide variety of investments;
- consider the suitability of potential investments;
- take proper advice.

3.2 The statutory regulations referred to above are supplemented with a general principle of fiduciary duty. There has been a recent legal opinion on fiduciary duty, (commissioned by the LGPS Shadow Advisory Board) and a report issued by DWP/BIS. Both conclude the prime focus of trustees should be the financial return generated from investments, but that other factors can be taken into account where the outcome does not have a material adverse effect on returns. This supports GMPF's longstanding view regarding the suitability of local investments.

## 4. GMPF – HISTORY OF LOCAL INVESTMENTS

4.1 Pension funds have long term liabilities and they therefore have the capacity to be long term providers of capital. This ability to take a long term view can be a valuable differentiator from other providers of capital and it is potentially more "valuable" in difficult economic environments.

4.2 GMPF's development of its local investment portfolio has tended to coincide with challenging economic environments. It is at these times that the greatest opportunities are available.

4.3 Risks associated with local investments have been managed by:

- putting arrangements in place to demonstrate commerciality of the investment opportunity, including other investors participating on the same terms, external management, external advice and the development of in house capacity and expertise;
- limiting all local investments to in aggregate to no more than 5% of Fund value (recently raised from 3%)
- adopting a branding for local investment funds to emphasise commerciality.

## 5. PRIVATE EQUITY/VENTURE CAPITAL

5.1 GMPF's first local investment was in 1982/83 with a £10m allocation to invest in local small companies in the North West known as the Business Development Fund. This programme was extended in 1988 with the creation of Ventures North West with a £20m allocation with further £20m allocation in 1995 and 2001.

5.2 The Fund appointed an external manager for these funds and their role included sourcing transactions, recommending investments, monitoring investments and recommending disposals.

5.3 In aggregate, these funds generated positive returns but lower than targeted and thus the decision was taken in 2005 to stop making new investments in this area. There have historically been disappointing returns for venture capital in the UK and Europe. The Fund has developed its approach to investing in SME's to focus on lending as detailed in section 9.

## 6. PROPERTY DEVELOPMENT

6.1 Greater Manchester Property Venture Fund (GMPVF) was established in 1990.

6.2 GMPVF undertakes direct development and redevelopment of commercial property. The target area for investment is in the North West of England with a focus on Greater Manchester. The Fund has an allocation of up to 3% of Fund value and the norm for the scale of investments would be in the range of 1% to 15% of the Fund's allocation i.e. a current upper limit per investment of around £60m.

6.3 An external manager is employed to source and evaluate potential developments, recommend investments, oversee the development process, manage the properties and recommend disposals.

6.4 GMPVF has concluded over 1.3m square feet of completed developments. The investment and development process is often time consuming and complex and this together with the unique brief of the Fund manager has meant that the rate of investment has generally been limited to 2 to 3 developments per year. The types of developments include:

- 17 Quay Street, Manchester, the former skin hospital site was redeveloped as an office with a major pre-let to an occupier consolidating its position in Manchester
- Supermarket, Hyde – large site assembled on a speculative basis
- Deva Centre, Salford – the former part listed Chester's Brewery was developed and refurbished to provide space for a broad range of occupiers bringing together government and local authority support as well as the Fund's investment
- Westwood Park, Wigan – 2 offices were built as the first phase of a new office park
- Quattro Park, Stockport – a new distribution facility
- Regional Science Centre, Oldham – speculative development
- 1 St Peter's Square, Manchester – 270,000 square feet prime office development in Manchester city centre.

The Fund currently owns sites for development in a number of Greater Manchester locations and elsewhere in the North West, including Liverpool, Warrington and Preston. A key challenge to progress opportunities is the scope to find occupiers willing to pay rents or acquire, that deliver the required financial return.

6.5 The property market had an excellent run from the early 1990's to 2008. This provided a helpful background for GMPVF investments. So far all completed investments have generated a profit.

6.6 The Fund's flagship development is 1 St Peter's Square, it has a prime location and sits alongside many of Manchester's civic and historical buildings. The City Council has refurbished the civic buildings alongside the Square; it is redeveloping the Square and the Fund's decision to invest in 1 St Peter's is acting as a catalyst for further development and regeneration.

This development was a joint venture with Argent and the decision to proceed with a 25% pre-let to KPMG was taken at a time when very little development was taking place following the banking crisis. With hindsight, the decision to proceed was excellent timing and the building is letting well. It was also the only significant development taking place in Manchester at commencement providing a boost to the local construction economy.

## 7. DIVERSIFICATION OF LOCAL INVESTMENTS

7.1 In recent years, the Fund has looked to broaden the types of opportunity in which it will invest. The aim is to build a diversified portfolio of investments albeit with a property bias. It is also looking to establish partnerships/joint working with other LGPS funds and private sector partners to increase scale and therefore reduce investment costs/improve net returns.

7.2 The current approvals are:

| Portfolio | % of Main Fund | Projected Commitments £m p.a. |
|---|---|---|
| GMPVF | 0-3 | 50+ |
| Housing | 0-1 | 50 |
| Impact/Collaboration | 0-1 | 50 |
| LPFA Infrastructure – JV | 0-1.5 | 150 |
| Other Projects | 0-2 | |
| Aggregate | 0-5 | |

## 8. HOUSING

8.1 The Fund has participated in a joint venture with Manchester City Council (MCC), which is its first direct involvement in building homes. The aim is to work with other Greater Manchester authorities to increase investment in homes. The purpose of the investment is to help respond to increases in demand for housing, support regeneration, provide benefits to the councils including new homes bonus and enhancement of council tax base and crucially from the Fund's perspective to generate a commercial return. The first project has been successful on these terms Construction has gone well as have sales and there is a high degree of certainty for the overall financial return to both the Fund and the Council.

8.2 In this first phase 240 homes are being built on 5 sites in Manchester, 4 of which were owned by MCC and the other by HCA. Of these 240 homes half are built for sale and half for market rent. The sales programme is going well and handover has started on the homes for rent.

8.3 The Fund provides all the capital to finance the development. MCC and HCA provide the 5 sites. Financial viability was determined in aggregate across the 5 sites and this facilitated more homes to be built sooner. It will also deliver financial returns that meet the needs of both parties. It also benefits Manchester's regeneration plans with good sites balancing more challenging regeneration areas.

8.4 The key roles in the development are the project manager and technical support and the prime objective is to manage risk through contracts including

- the builder for construction risk
- the tenant who has taken a long lease on all the homes for market rent and who will undertake the property management role taking on void and repair risk
- the sales agent

8.5 A key risk that is not mitigated is the ability to sell the homes at the planned price and to programme. So far the sales programme is going very well, reflecting affordable prices for 2, 3 and 4 bed homes.

8.6 The project has been resource demanding for both partners with significant staff time and finance needed to develop and implement the following which can now be transferred to future projects:

- an investment model
- site identification and land preparations
- legal structures for partnership
- procurement of delivery agents
- project delivery and monitoring

## 9. IMPACT PORTFOLIO

9.1 The fund participated in the "Invest for Growth" initiative with 5 other LGPS funds. The aim is to deliver commercial returns and for the investments to have a social impact. Due diligence was shared between the participating funds and GMPF invested in opportunities targeting property, loans to SMEs, and social impact bonds.

9.2 The next phase, learning from our experience, is to build a local "Impact" portfolio. Again the aim is to build a diversified portfolio investing in funds and co-investments and investing in different parts of the capital structure. The current plan is to target opportunities in property, loans to SMEs and local infrastructure. Other North West funds may co-invest in some or all of the investments made adding to and benefitting from the economy of scale benefits including in-house resources.

## 10. INFRASTRUCTURE JOINT VENTURE WITH LONDON PENSION FUND AUTHORITY

10.1 Agreement has been reached with LPFA to create a joint venture to invest in infrastructure. Both parties have committed £250m each. Oversight will be exercised by the GMPF Management Panel and LPFA Board.

10.2 GMPF and LPFA will both allocate significant in house resource to this project with investment decision making delegated to officers. The aim is to build a diversified infrastructure portfolio through a wide range of approaches. The aim is to commit investment over a 3 year period. Both Funds have recognised the need to reduce investment costs and this direct approach should have considerably less fees than a comparable fund or fund of fund structure.

10.3 The definition of infrastructure is broad with both organisations having the capability of sourcing investments and these investments are expected to have a bias to the partners' location.

10.4 The legal arrangements are structured to facilitate other funds joining the JV in future.

## 11. OTHER PROJECTS

11.1 The Fund has also looked to partner on major projects with organisations with access to high quality deal flow and who can bring development expertise and share financial risk. The main project that the Fund is currently involved in is Airport City Manchester.

11.2 This project is part of an Enterprise Zone. It is a long term project with the aim of undertaking approximately £800m of development over the next 15 years.

- In March 2011 Manchester Airport was confirmed as the location of one of the UK Government's vanguard Enterprise Zones. Centred on the new Airport City development area, businesses will be offered incentives in order to create new jobs and stimulate economic growth locally, regionally and nationally. The incentives include savings on business rates, the introduction of super-fast broadband and the local authority will be allowed to retain business rates.

- The 116 hectare Manchester Enterprise Zone sits around the new strategic scale development of Airport City involving the creation of a significant new business destination in the area adjacent to the airport's terminals and ground transport interchange. Complementing this will be health and biotech related research and development and training facilities associated with MediPark which also benefits from the proximity of Manchester Airport.

- The plans envisage Airport City to be a very significant development as its name suggests. The intention is that "Airport City will become an international business destination providing world-class environments in which people work, play and stay. A vibrant economic hub with connectivity at its heart, it aims to be one of the world's most accessible and leading commercial locations".

- "Airport City will reposition Manchester Airport as a key international business destination."

11.3 The partners in this project are Manchester Airport, BCEG (Beijing Construction and Engineering Group), Carillion and GMPF.

11.4 In addition to its equity participation in the Joint Venture, this may provide deal flow opportunities for the Fund to acquire long term assets and provide debt to some Joint Venture projects.

## 12. EVALUATION OF BENEFITS AND RISKS OF LOCAL INVESTMENT AND MITIGATION

12.1 Pension funds generally have the capacity to be long term providers of capital. Increasingly LGPS funds are seeking long term secure income streams as well as capital gains to help manage funding volatility. The capacity to provide long term capital particularly at times when markets are challenging makes LGPS funds a credible investor and partner for developers. This can also result in investments being undertaken that would not otherwise have occurred or earlier than would have been the case.

12.2 For successful investment, there is a need to

- identify an investment opportunity that meets return criteria
- be able to access such opportunities
- be able to make the investment decision

12.3 For local investment to work well there needs to be the capacity and capability to deliver on the tasks set out at 12.2. If for example, the local area is providing very few opportunities, then identifying opportunities will be very unlikely.

12.4 GMPF's Management Panel has aimed to build diversified portfolios over time learning from its experiences. Its advantages are the economic strength of Greater Manchester, the scope to allocate significant sums without building material concentration risks and a willingness to resource such investment programmes.. The Fund uses a variety of arrangements to gain its exposure including external managers, Joint Ventures, in-house resources and support from independent advisors. The Panel's view is where there is scope to invest locally and generate comparable returns to other investments; there is merit in investing locally to capture the benefits of supporting the area, subject to managing the relevant risks.

12.5 Local investment is sensitive and brings with it reputational risks should the investment not perform in line with the business plan/appraisal. Hence the importance of a thorough due diligence and evaluation process to demonstrate a decision based on commercial criteria.

12.6 It can also be complex, e.g. the financial appraisal and it will often involve legal, project management, procurement, financial and other specialist skills. The type of investment and the capability and capacity of the in-house team will determine the process for evaluating and progressing investments.

12.7 In summary, local investment is demanding at Board level from a governance perspective and operationally. The costs of a local investment programme will be materially higher than the investment management costs associated with a standard securities portfolio. However, with appropriate capability and capacity either individually or through collaboration, local investment delivering on the twin aims of commercial returns (that deliver long term returns in line or better than the Actuary's return assumption) and support for the area is considered by GMPF to have great merit.